

Status of U. S. federal tax policy encouraging bioenergy projects

A. Rotroff* , G. Sanderson

Sanderson & Rotroff, LLP, Suite 535, 2000 Powers Ferry Road, Marietta, Georgia, USA 30067

Fax: 770-953-3021; arotroff@sandrllp.com

Summary

This paper will explore the policy of the United States government of encouraging the development, production and sale of alternative fuels produced from biomass. It will outline existing incentives and the U. S. public policies which inspired their enactment, as well as any changes to existing incentives or new incentives proposed or enacted this year. It will examine whether such changes indicate a shift in policy, and any effect on policy resulting from current events such as the dramatic increase in natural gas and petroleum prices, the scarcity of electricity in California, and the change in the presidential administration. This paper will also examine barriers in the implementation of U.S. policy that may prevent taxpayers from fully benefitting from tax incentives as intended by Congress. Finally, this paper will provide guidance as to what steps taxpayers should take to assure that a project is structured consistently with Congressional energy policy to assure that the taxpayers will qualify for the incentives.

Policy Behind Existing Incentives

For more than two decades, the United States government has encouraged the development of alternative energy projects through the use of tax incentives. The most significant of these incentives relating to bioenergy are the tax credits (the “Credits”) provided under the Internal Revenue Code of 1986 (the “Code”) which include the following:

1. §29 credit for the production and sale of gases produced from biomass or synthetic fuels;
2. §45 credit for the production and sale of electricity from closed-loop or poultry waste biomass and wind energy resources; and
3. §40 credits for the sale or use of alcohol as a fuel.

All of these Credits were created to entice taxpayers to place in service facilities for the long-term production and extraction of fuels from alternative sources. Congress originally enacted the §29 and §40 Credits in 1980 to, in its words, remedy “an extremely serious energy problem.”[1] Congress noted that the nation possessed “substantial energy resources” which businesses were not inclined to exploit without government incentive or subsidy, and Congress considered it imperative to grant a limited, but long-term mechanism to encourage such resource development.[2]

A similar policy encouraging the development of alternative energy sources is set forth in the Energy Security Tax Policy Act of 2001 proposed in February of this year (the “2001 Energy Bill”). After finding that the increasing dependence on foreign sources of oil is causing harm to the U.S. economy, threatening national security and jeopardizing the welfare of the American people, and noting that the United States lacks a comprehensive energy policy, this legislation was proposed for the purpose of protecting the energy security of the United States by reducing dependence on foreign oil by, among other things, “enhancing the use of renewable energy sources” and “increasing domestic energy supplies.”[3]

Implementation of Policy

Given this clearly stated, and apparently ongoing, policy of Congress to use tax incentives to advance both the production of alternative fuels and the development of the technology required to achieve such production, one would expect the United States government to implement its policies in a way that would

facilitate the claiming of the Credits. Such has not been the case. Developers of alternative fuel projects have had to overcome numerous barriers to claiming the Credits including an overly restrictive interpretation of the Code by the Internal Revenue Service (the "Service"), the application of tax shelter regulations to tax credit projects, as well as limitations caused by the complexity of the statutes themselves. All of these barriers have served to limit the availability, or at least complicate the claiming of the Credits.

This lapse between the intent of Congress that the Credits be used to encourage taxpayers to develop and use alternative fuels, and the ability of taxpayers to avail themselves of the Credits has been recognized by some members of Congress. In the past two to three years, there have been attempts to expand the availability of the Credits to the taxpayers. In 1998, the life of the §40 credits was extended from a scheduled expiration of 2002, to last through 2007. In 1999, the §45 credit was extended to cover facilities placed in service by December 31, 2001 rather than the earlier deadline of July 1, 1999.

Nevertheless, most attempts to expand the availability of the Credits have failed. For the §40 credit, attempts to raise the production ceiling for the small producer credit from 30 million to 60 million gallons, to permit the credit to offset alternative minimum tax, and to exclude the credit as income in the calculation of income tax all failed. Attempts to expand the §45 credit to include electricity produced from non-closed-loop biomass, and to extend the life of the §29 credit also both failed. Further, a measure that would have exempted §29 and §45 from tax shelter scrutiny was not enacted. As a result, little has been successfully done to improve the availability of the Credits.

Many in the industry seem to be fairly optimistic about the prospect for the expansion and increased availability of the Credits during the current session of Congress. The 2001 Energy Bill sponsored by Murkowski of Alaska would open up the §29 credit to wells and facilities placed in service from the time of enactment through 2011 and would extend the life of the §29 credit through 2012, although the credit would be gradually reduced each year beginning in 2009 until it was eliminated in 2013. It would also broaden the §45 credit to include a credit for electricity produced from non-closed-loop biomass, such as agricultural and wood residues, and landfill gas.

Increased availability of Credits for taxpayers may result from enactment of the 2001 Energy Bill or other proposed legislation. The extent to which any enacted legislation will cure the lapse between Congressional intent that the Credits be available to taxpayers, and the ability of the taxpayers to qualify for credits will not be evident until actual enactment. However, this lapse will not be fully cured unless the legislation is carefully drafted, Congressional intent is clearly and unequivocally stated, and the Service interprets the law consistent with the intent of Congress.

References

[1] See S. Rep. No. 95-529, 95th Cong., 1st Sess. (1977), concerning discussion of the Energy Production and Conservation Tax Incentive Act, the bill which first introduced the "nonconventional fuels credit." The credit was ultimately enacted as part of the Crude Oil Windfall Profit Tax Act of 1980.

[2] S. Rep. No. 95-529, 95 Cong., 1st Sess. (1977). The purpose is further explained in the legislative history of the Crude Oil Windfall Profit Tax Act, S. Rep. No. 394, 96th Cong., 1st Sess. 87 (1979), 1980-3 C.B. 131, 205.

[3] See the Title IX Provisions in National Energy Security Act By Sen. Frank Murkowski (R-Alaska), Sec. 2.